NBURSEC

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
----------x

Securities and Exchange Commission,

Plaintiff,

v. 23 Civ. 1346 (JSR)

TERRAFORM LABS PTE LTD., *et al.*,

Oral Argument

Defendants.

----------x

New York, N.Y.
November 30, 2023
3:30 p.m.

Before:

HON. JED S. RAKOFF,

District Judge

APPEARANCES

SECURITIES AND EXCHANGE COMMISSION
Attorneys for Plaintiff
BY: DEVON STAREN
JAMES CONNOR
LAURA E. MEEHAN
CARINA CUELLAR
CHRISTOPHER CARNEY
ROGER LANDSMAN

DENTONS US LLP
Attorneys for Defendants
BY: DOUGLAS W. HENKIN
LOUIS PELLEGRINO
MARK CALIFANO

NBURSEC

(Case called)

MS. STAREN: Devon Staren for the Securities and Exchange Commission.

MR. CONNOR: Good afternoon, your Honor. James Connor for the S.E.C.

MS. MEEHAN: Good afternoon, your Honor. Laura Meehan for the S.E.C.

MS. CUELLAR: Good afternoon, your Honor. Carina Cuellar for the S.E.C.

MR. CARNEY: Good afternoon, your Honor. Christopher Carney for the S.E.C.

MR. LANDSMAN: Good afternoon, your Honor. Roger Landsman for the S.E.C.

THE COURT: So who is minding the store back at the office?

Go ahead, counsel.

MR. HENKIN: Good afternoon, your Honor. Douglas Henkin for the defendants.

MR. PELLEGRINO: Good afternoon, your Honor. Louis Pellegrino for the defendants, and I believe we'll be joined by paralegal Sarah Gonzalez in a moment.

THE COURT: That's fine.

MR. CALIFANO: Mark Califano for the defendants, your Honor.

THE COURT: Good afternoon. So we're here for an

argument on summary judgment. This was originally supposed to occur at 4:00, but the Senate of the United States confirmed a new judge for the Southern District of New York a day or two ago and a bunch of judges, including myself, have been asked to meet with her at 4:30 today to help train her in our ways, from which she will never recover. So we have an hour. So I'm going to ask counsel not to reiterate what is already in their excellent papers, but just to pick one or two points that they particularly want to emphasize on the cross-motions for summary judgment.

Before we get to that, though, there's a matter that regretfully I have to raise just to make it a matter of record. So in the motion papers that were submitted by the defense in support of their motion for summary judgment, there was included a declaration of Mr. Raj Unny. It was a 26-page declaration with a modest 185 pages of exhibits attached thereto. And the S.E.C., on October 31, called and said this was really an unauthorized surrebuttal report that should not be allowed because not only had expert discovery and depositions been concluded but all discovery had been concluded, and no application had ever been made to file a surrebuttal report. The defendant said, no, this is not a surrebuttal report. It's not an expert report. It's simply a declaration that is being submitted in support of their motion for summary judgment. So I said, well, what I would do is read

it and then determine whether I should consider it on summary judgment.

Subsequently, we had a Daubert hearing, and although I have not issued the full opinion, I have issued the bottom-line which included striking the testimony of Mr. Unny as an expert. And although by that time I had read his declaration submitted in support of summary judgment, I think based on what defense counsel had represented to me over the phone, it should have played and really should not play any role in the Court's Daubert decision. Nevertheless, for what it's worth, that decision would have been the same so far as Mr. Unny is concerned either way.

When I was reading the papers on summary judgment, I returned to Mr. Unny's declaration, and it appears to the Court unequivocally to be a surrebuttal expert opinion that, of course, could never have been inquired into on deposition by the plaintiffs because it was issued without permission after all the discovery had been completed. And it says, for example, in paragraph two, "Dr. Edman has subsequently filed the rebuttal report of Dr. Edman on October 13, 2023." Let me pause there to say that was with the full permission of the Court after hearing from both sides. But continuing the quote, "I have been asked by counsel for Terraform Labs, or TFL, and Dr. Do Hyeong Kwon to review and assess the opinions put forward by Dr. Edman in this rebuttal report." That certainly

sounds like an unauthorized surrebuttal expert report, which the S.E.C. had no ability to take a deposition about because it was submitted without authorization and after discovery had closed.

Nevertheless, troubled though I am very much by the representations that defense counsel made to me on the phone, I have decided to consider this report for purposes of summary judgment, but I'm not considering it for purposes of Daubert based on defense counsel's representation to me that it wasn't part of Daubert. Anything defense counsel wants to say about any of that?

MR. HENKIN: No, your Honor. I think what you've done in characterizing it is something that defense understands.

THE COURT: All right. Very good. So we have cross-motions. Let me hear first from the S.E.C.

MS. STAREN: Would your Honor like me to stay here or go to --

THE COURT: Go there. I think everyone can hear you better from there.

MS. STAREN: This time I did not drop my papers.

Good afternoon, your Honor, and May it Please the Court, we're here today because defendants Do Kwon and his company Terraform Labs orchestrated a multibillion-dollar fraud. Defendant's fraud is not novel, and it is not complicated. Quite simply, they created a security, LUNA.

They represented it to investors as the equity of the Terra blockchain, and they linked its value to the successful Terra economy. Defendants then embarked on a campaign to increase LUNA's price on a number of fronts, including by artificially inflating Terra blockchain activity with fake transactions that they falsely represented were real-world blockchain payments through a company called Chai. At the time, defendants launched a near continuous stream of promotional statements highlighting the various efforts they would and did undertake to promote and grow the Terra economy. When UST and LUNA nearly crashed in May of 2021, defendants secretly brought in a third party to help restore UST's peg, and then falsely reassured the public that the algorithm had "self-healed." Throughout this time, of course, defendants held on to hundreds of millions of LUNA tokens that they created --

THE COURT: Forgive me for interrupting. Let me ask you a few questions.

MS. STAREN: Sure.

THE COURT: First, are you contending that the mAssets are themselves securities?

MS. STAREN: No, your Honor.

THE COURT: Okay. That was my understanding of your papers. I just wanted to be sure.

Second, with respect to the fraud claims where intent is an essential element, how can that be a matter of summary

judgment?

MS. STAREN: So, your Honor, in this case, starting with the Chai fraud, the undisputed evidence here comes in the form of defendant's own internal and external communications, and those communications make clear that defendants were very much aware that Chai did not use the blockchain for purposes of processing its payments.

First, we have Do Kwon's own statements. In June of 2019, as defendants do not dispute, he told Terraform's marketing director while Chai was start part of Terraform, and he said, We are not using any Terra blockchain technology. And he instructed her to not tell the press that Chai was using the Terra blockchain technology. He knew Chai wasn't using the Terra blockchain. Again, in March of 2020, we have an undisputed statement that Do Kwon made in an email -- internal email to Terraform employees where he explained that Chai and Terraform were going to split. And the reason for the split is so that Chai could operate its payment processing business as a licensed payment platform within Korea and consistent with Korean regulation, but that going forward, "Its business will have nothing to do with Terra." He recognized that Chai was not going to be using the Terra blockchain because it couldn't.

Similarly, we have internal communications that demonstrate Do Kwon himself directed that Terraform put millions of sham transactions on the Terra blockchain by

following Terraform's own KRT to and from their own accounts in order to replicate Chai transactions that were happening in the real world in fiat currency.

THE COURT: What about the other claim?

MS. STAREN: With respect to the May 2021 depeg, once again, we have defendant Do Kwon's own internal communications which, again, are undisputed. On May 23, the day of the significant drop of UST's price, Kwon told a Terraform employee that he was "speaking to Jump about a solution." He also told a Terraform employee that the peg had to be defended, and he held a meeting where he told a group of Terraform employees that Jump was deploying $100 million to buy back UST.

Defendants already admit that Do Kwon had communications with a Jump executive on that day, and defendants already admit that Do Kwon and that Jump executive discussed "efforts to restore the dollar UST peg." And then, of course, we have the declarations by the Jump employees who tell the other side of the story. And they are able to testify that that Jump executive told Jump employees, I spoke to Do and he is going to vest us. The undisputed evidence here establishes that Do Kwon and Jump established an agreement on May 23 so that Jump would step in and buy up UST. And then defendants turned around and told the public that the algorithm had self-healed when they knew that they had brought in a third party to buy UST in an attempt to restore the peg. Those

statements were false, and they were misleading and they were material as a matter of law.

THE COURT: All right. I interrupted you. Go ahead with whatever else you wanted to cover.

MS. STAREN: Sure. I think here the issue, obviously, is going to be evidence, and the S.E.C.'s position is that while the S.E.C. has, of course, presented overwhelming and admissible evidence in support of its motion for summary judgment, the defendants have proffered virtually nothing. And as mentioned, the vast majority of the S.E.C.'s evidence is in the form of communications and statements that defendants do not even attempt to dispute the contents of. This includes, of course, defendant's own internal and external communications. It includes deposition testimony from Terraform employees, investigative testimony from Do Kwon, and purchase and loan agreements and communications between defendants and buyers of LUNA and MIR.

And the S.E.C. has also submitted sworn declarations and associated documents from summary and fact witnesses, including whistleblowers at Chai and Jump, representatives of intermediary firms that purchased tokens from defendants and then resold them into public trading markets, and, of course, U.S. retail and institutional investors that were defrauded by defendants. And although defendants purport to dispute some of this evidence, they utterly fail to create a genuine dispute

under Second Circuit law and the rules of this district because the defendants do not offer admissible evidence to contradict it.

Bluster, hyperbole, assertions of critical context that are provided by defense counsel is not evidence. And if you look at the actual documents defendants rely on, they are either not admissible, they are not material, or they do not support defendants' assertions. By way of example, one document, Opposition Exhibit 18, defendants claim that this demonstrates that Chai used the blockchain to process and settle transactions. In fact, it is a marketing agreement between a Chai merchant, Chai and Terraform, and it provides for discounts, payable in fiat currency, Korean won. And the agreement does not mention blockchain technology at all.

Even worse, defendants' point to a Chai merchant agreement, Opposition Exhibit 19, as evidence, again, that Chai processed and settled transaction on the blockchain. In fact, this merchant agreement provides that the merchant would be "settled by payment to a bank account." Defendants point to language in the agreement providing for reduced fees. "If Terraform Labs PTE. Ltd. integrates the Terra service and open banking API." "If", if Terra's service is integrated. This means that Terra's service was not integrated as of the time they signed that agreement, which, if you look at it, was dated August 23, 2019. All defendants have done by placing this

document into evidence is prove that Do Kwon was, in fact, lying in June 2019 when he told the world in his Medium post that Chai "runs" on Terra's blockchain, which is in Defense Exhibit 74b.

Now, because defendants have no evidence to support their case, they resort to arguing to exclude the S.E.C.'s evidence. Defendant's arguments should be disregarded for the reasons described in our reply brief. The S.E.C.'s fact-witness declarations are admissible, they are probative, and they are damning, and the defendants offer no admissible evidence to controvert them. Thus, there is no genuine dispute of material fact, and the S.E.C. is entitled to summary judgment on all its claims.

With respect to *Howey* in particular, because defendants do not dispute the contents of their statements, there is no dispute about what defendants told investors. Defendants only real argument there is a legal one that has already been rejected by this Court.

THE COURT: Let me interrupt again. So I want to focus on mAssets again and on your fifth and sixth claims for relief, which are that defendants offered unregistered security-based swaps to non-eligible contract participants in violation of Section 5(e) of the Securities Act, and affected transactions and security-based swaps with non-eligible contract participants in violation of Section 6 -- I think it's

6(l) of the Exchange Act. The Commodity Exchange Act defines a swap as "Any agreement, contract or transaction that provides on an executory basis for the exchange of one or more payments based on the value or level of one or more securities, and that transfers, as between the parties, to the transaction in whole or in part, the financial risk associated with a future change at any such value or level, without also conveying a current or future direct or indirect ownership interest in an asset."

Since, as you've already agreed mAssets themselves are not securities, how do you fit them under these provisions?

MS. STAREN: Sure. So the S.E.C.'s position with respect to the mAssets are that the transaction creating the mAsset is the security-based swap. And the way that this security-based swap functioned is that the user could go to the defendant's website at mirror.finance and could choose to create or mint an mAsset. And when they did so, they would have to or were required to deposit collateral in the form of UST equal to 150 percent or more of the value of that referenced underlying asset. Let's say it's a U.S. security, Apple, for instance, and because of the way that the transaction --

THE COURT: Yes. Again, I apologize for interrupting, but it's not clear to me how the holder of an mAsset passes on any financial risk associated with the future change in the value of the security to a counter-party since the holder bears

all the risk himself.

MS. STAREN: So I think the S.E.C.'s interpretation is that the financial risk is actually being transferred to the investor, to the one minting the asset. They are the ones that have the financial risk such that if you --

THE COURT: How is that? Because, as I understand it, if there's a change in the value of the underlying portfolio, the holder has to increase their amount of their contribution.

MS. STAREN: That's correct.

THE COURT: So what is the risk that is being passed on?

MS. STAREN: So the risk that is being passed on is that if they do not increase the collateral -- maintain the 150 percent ratio, they risk losing their entire collateral. It would get liquidated through the protocol.

THE COURT: Okay. All right. With apologies, I know you were in full flight, but since we have such limited time, let me hear from your adversary. We'll come back to you shortly.

MS. STAREN: Sure. Thank you, your Honor.

MR. HENKIN: Good afternoon, your Honor, May it Please the Court, Douglas Henkin for the defendants. What Ms. Staren said is correct. This is about evidence but it's also about legal issues. And the motions before your Honor are asymmetric. The defendant's motion for summary judgment has to

be evaluated on whether there's a lack of admissible evidence that the S.E.C. has submitted, on issues on which they bear the burden of proof, which are all but one. The one that the S.E.C. doesn't bear the burden of proof on are exemptions from registration; whereas, the S.E.C.'s motion has to be evaluated on whether it has offered admissible evidence proving every element that it has the burden of. Even if the Court thinks the S.E.C. has offered admissible evidence on an element that it bears the burden of proof on, which it shouldn't for reasons such as the ones your Honor was describing, with regard to mAssets. And I think your Honor got it right, by the way, with respect to that last part of the conversation.

That doesn't mean the S.E.C. gets summary judgment because the defendants have demonstrated that there would still be factual questions to be resolved in these circumstances. And that can be done by, for example, demonstrating that a witness has bias or has lack of personal knowledge or has -- or that testimony is hearsay. So this is a case --

THE COURT: Of course, I understand you don't agree with my interpretation of *Howey* and so forth, but that's neither here nor there. I've decided that on a motion to dismiss. So assuming that the facts that make certain of these instrument securities is itself undisputed and all that is in dispute is the legal interpretation I previously made, why is your adversary not entitled to, at a minimum, summary judgment

on the failure to register securities?

MR. HENKIN: So for several reasons, your Honor. First of all, I respectfully disagree that the interpretation of *Howey* in this case was set or could have been set by the motion to dismiss for two reasons. One, it was just a motion to dismiss; and, two, there are different arguments that have been presented here with respect to how to interpret *Howey* and how to decide if *Howey* is even good law with respect to the interpretation of the S.E.C.

THE COURT: All right. So let's assume that those new arguments are unsuccessful. Let's assume hypothetically I haven't made any decision, that I'm still not persuaded that most of these instruments were not securities, but rather believe that they were securities under the law. What then is left, assuming my hypothetical, with respect to summary judgment on the lack of registration?

MR. HENKIN: So what is left is whether, in fact, the instruments do satisfy the *Howey* test.

THE COURT: Okay. I think we're on the same wavelength. So you agree that if contrary to your arguments, old and new, that I find that on the undisputed facts, these were securities that then the S.E.C. is entitled to summary judgment on the failure to register?

MR. HENKIN: No. Then we go to the exemption questions, your Honor.

THE COURT: Okay. Again those -- well, all right. Fair enough. Those are largely legal issues. They are not perhaps entirely --

MR. HENKIN: No, I don't think so, your Honor, and let me give you an example of why not. With respect to the -- and this really ties together with the interpretation of *Howey*. And the S.E.C.'s view of how Howey work is that these instruments, with the exception of mAssets which we've now dealt with separately, are investment contracts.

THE COURT: I like, by the way, the turn of phrase of "how *Howey* works." I'll remember that for future use.

MR. HENKIN: Maybe on December 8, your Honor?

THE COURT: Yes.

MR. HENKIN: That's their view of how *Howey* works, and you have to go back and look what was at issue, what the record was before the Supreme Court. We submitted the entirety of it. It's actually not big. It's part of the record, and I would urge your Honor to look at it. And I'm going to get to that. But before I get to that, there are two parts of this and they are really two sides of the same coin.

(Continued on the next page)

MR. HENKIN: On the one hand, the SEC says, We want you to infer the existence of a contract between TFL, for example, and purchasers of UST or LUNA on the other hand, from the way things were marketed, things that were said on YouTube interviews or in press interviews or in other things, but they want you to infer the existence of a contract and the terms of a contract. Because the requirement is -- again, on their view, with which I do not agree -- that investment contracts can be used under these circumstances. They want you to infer that there was a contract and what its terms were, where there is nothing in writing, as there was in *Howey* and every other case that has followed *Howey*, and we cite all of them in our papers.

On the other hand, what you have is a situation, with respect to the exemptions, in which you have token purchase agreements or token sale agreements that are written contracts, that have these specified terms that relate directly to, for example, Regulation D exemptions, Regulation S exemptions, Section 4(a)(2) exemptions. And those are things that the Court would have to look at. But the SEC says, Those are just things in pieces of paper; they shouldn't count.

They can't have it both ways. If they want your Honor to infer contracts on the side of whether something was a security, then your Honor also has to consider what the effect of contractual terms in contracts that were actually reduced to

writing, and exist, and are before the Court, and are not disputed. In fact, the SEC has offered those as affirmative evidence. But they can't have it both ways.

THE COURT: That's an interesting point.

I do want to -- again, with apologies, but because of the time limitations -- hear what you have to say on the fraudulent intent issues on the fraud claims.

MR. HENKIN: Okay. With regard to -- and my colleague is going to address Chai. I will address the depeg. This case is actually the opposite of a normal 10b-5 case. And it's interesting that Ms. Staren actually confirmed that the SEC's allegations about the May 2021 depeg are about what first happened in May and what was said about it later.

The normal 10(b) case is an allegation that on day one, for example, somebody said something that was false then, and then the truth was discovered sometime later. Your Honor has had, I don't even know how many cases like that. This is the reverse. What the SEC's allegation here is, is that something happened in May, that in fact the true cause of the repeg was actions by Jump -- and that's the subject of disputed expert testimony, significantly disputed expert testimony -- and that statements made after that were false because the SEC says, we are right, in fact, it was really the Jump actions that caused the repeg.

So if, in fact, that turns out to be wrong, then those

post hoc statements are irrelevant. They can't be true or false, because the predicate for them being true or false, that Jump caused the repeg, is false.

The fact of the matter is your Honor has allowed both Professor Mizrach and Professor Hendershott to stay in. And that means that there is, at the very least, an issue of material fact. There is a substantial dispute, as discussed by Professor Hendershott, in his report. We disagree with your Honor's decision not to exclude Professor Mizrach. I'm not going to relitigate that now. But with him in the case, even his testimony at the *Daubert* hearing creates issues of fact. And I will give you an example. This is just one.

THE COURT: I need to interrupt you because you said daw-bert. And although lots of people say daw-bert, in fact, Mr. Daubert is on record saying he pronounces his name dow-bert.

MR. HENKIN: Dow-bear. I'm sorry.

THE COURT: Not dow-bear. Only French people say dow-bear. He says dow-bert. I think it's the Brooklyn pronunciation.

Go ahead.

MR. HENKIN: Just Professor Mizrach's statements about what he called -- when your Honor asked him about the negative prices that his model produced, a couple of things happened.

First of all, he offered opinions that were not in

either of his reports.

Second of all, he said that negative prices only occurred in what he referred to as the tails, implying that negative prices occur only with a small probability, which is what being in the tail of a distribution means. And that this was due to the standard errors of his estimates being large. That was on page 55, lines 8 and 9 of the *Daubert* transcript. That's wrong. Standard errors determine the width of a confidence interval. Larger standard errors cause the confidence interval around the midpoint of an estimate to be larger, not smaller.

So, if we were to go to trial, what Professor Hendershott would testify is that, because the midpoint of the confidence interval for the price impact from Professor Mizrach's model was 1.303, that means that there would be 96.6 percent chance that his model was predicting a negative value. And if he cut that down, the probability would only go up. So if he reduced the standard error, it would only go up.

That means that there is going to be a significant fight in terms of the experts on the causation question that's at the core of that part of the SEC's fraud theory.

I would like to let Mr. Califano address Chai.

THE COURT: That is a good idea.

MR. CALIFANO: Thank you, your Honor. I am going to break this down into a couple of quick pieces because I know

the Court has time constraints.

One of the first things I want to address is the SEC's attention to specific factual statements. I think one of the examples they gave was in paragraph 167 of their 56.1 statement, and we have a counter to that which I think the Court should read. But this is a great example because the only thing they cite in that particular discussion is one discussion about how one communications person was going to make a comment with respect to what Chai has tested as opposed to what Terraform Labs was doing, which was using a blockchain for Chai and its transactions. And later down in that conversation there is explicit discussion about it. So any suggestion that this was a concealment is very misleading and mischaracterizes the statements.

I can go through the 20 or so statements that the SEC has done that with, but what we find is this. On their face, they are not false, and it is the defendants' position that they are not false. In many cases, and especially when we have the entire statement, not just a piece of it, and that happens at least six to ten times that we can count, and we have identified those in our counterstatement, it is very clear that that is not what they say. When they say that statements that Do Kwon makes say that merchants accept KRT in payment, that is not what those statements say, not on their face and not in any way. They talk about settlement with respect to the

blockchain.

Now, your Honor, I am going to leave those statements because our position on them is very clear. We think they have been misrepresented. We think on their face they are very clear and not false. But more importantly, the basis of the fraud that the SEC, and the basis of their evidence, is from two sources. The first source is their whistleblower witness, the Chai witness, who I understand, your Honor, until you give us instruction otherwise, we are not to name, so I will not.

That particular person has no personal knowledge about the functionality of Chai's payment system, nor does he have any personal knowledge about the LP server. These are from his own statements, many of which he surreptitiously recorded, one of which we only received because the Court compelled him to produce it. And, of course, later, in his deposition, we discovered that he had additional recordings that he had not produced pursuant to that subpoena.

However, a couple of things he did admit. He did not develop the Chai payment code. He wasn't around when that happened. He only managed the software developers. He did not work on any code. He did not produce Chai payment system code or any operational data at all. We have none of that. And the SEC has never gotten it, in fact. He never examined the LP server codes, and he had never heard of a top-up source code, and he did not know about the LP server code until shortly

before he left. And how he learned about it was by asking the head of engineering --

THE COURT: I don't think it's the SEC's position, that we will hear in a minute or two from them, that I could award them summary judgment on the issue of scienter, or for that matter, the issue of fraud, based solely, or even substantially, on the whistleblower testimony, because it's clear that you have disputed that testimony in enumerable respects. So what I just heard from them, however, was reference instead to things that have come out of the mouths of your clients, in effect.

MR. CALIFANO: Yes, your Honor. And in our counterstatement, we have disputed each and every one of those interpretations by the SEC, and in many cases we have actually provided the Court with the full discussion. In many cases, when Do Kwon or TFL is discussing a vision or a plan, they have mischaracterized it as the actual representation of functioning, which it most certainly is not on the face of it. And it's clear by the words that it's not.

In other cases, they have taken one, and this is an interesting case where they have suggested, for example, that in a discussion between Mr. Kwon and Mr. Shin, where there is a discussion of generating fake transactions, they have said that this is evidence of exactly what they did with Chai. But in reading that conversation, the very plain language of that

conversation, it has nothing to do with Chai. Those transactions and that discussion concern SDT, which is a different type of stablecoin, which is used by validators in conducting transactions on the main net, not with Chai, never with Chai. It never involved Chai. And, in fact, it was a public project. It was called Project Santa, which was publicly announced, in which the validators participated in generating those transactions.

There was a purpose for that. And the purpose was this. Because of the mechanism, whereby the stablecoins were managed through the algorithm with LUNA and the variable price of LUNA, there was no way for those validators to actually get benefit from the normal inflationary value of tokens on a blockchain as the blockchain begins to grow. They can't do that. So they had to find an alternative way. And actually, in this discussion, they do discuss this. They discuss the fact that they have to give that incentive to the validators in order to continue to operate the blockchain, until, hopefully, other protocols take off and make the blockchain more active.

The very big concern that the defense has with that is that that is a primary example of something that has absolutely no probative value, it's highly prejudicial, and is exactly the kind of thing that courts prohibit from admitting. Because the suggestion and the supposed stink of that had nothing to do with what they have alleged as a fraud. And that's one of the

most important examples I can give you.

THE COURT: All right.

MR. CALIFANO: I want to just continue with one or two other things.

THE COURT: Quickly, though, but I will be glad to hear you.

MR. CALIFANO: Very, very important. In the discussion in which the SEC's whistleblower witness is trying to learn how the LP server works, there is some very important statements made by the Chai engineer that is important for the Court to understand. The first one is that the LP server resides in the Chai server, it's part of the Chai system. The second one -- I am going to make it three. The second one is that the LP server transactions were part and parcel of what Chai did. When a consumer made a transaction with a merchant, it executed two pathways. And the engineer references both pathways. But even more important, what the engineer tells this witness is, from Terra's perspective, the transactions has a mirror so I think they are settling. Not paying. In the eyes of that engineer, settling was occurring through the LP server.

That's important, because the only thing that this witness has to talk about with respect to that activity is what he has been told by others. He has no independent knowledge and no personal knowledge whatsoever. And as proof of that,

twice this witness, once in a deposition and later in an actual declaration in support of this motion for summary judgment, tries to explain why he asserts that Chai doesn't use the blockchain. The first time he does it he says, Chai doesn't use the blockchain because the transactions that the LP server actually executes have already been settled with the merchants. But that's false. It's provably false. Those transactions that the LP server executes are executed within seconds of a consumer buying or transacting with a merchant. Merchants buy the exact agreements that were just cited by the SEC and get paid 14 days later. That's not the way this system works. It was demonstrably not that way when he said it, and it is still that way today.

Secondly, in his own declaration, in which he begins to describe things that he never described in his deposition or in any other statements whatsoever that we have, he insists that one of the reasons that he knows that Chai does not use the blockchain is because of the way that Chai actually settles with merchants on a, quote, monthly basis. But that's false. He was told, again, by that same engineer, that Chai settles every day, like every other payment system, your Honor, that has ever used that kind of a process. There is a 14-day settlement period, and that's the period of settlement that was used.

In both cases, he was given two slow highballs to

swing at, to try to explain why he has personal information, and in both cases he failed. He failed because he really doesn't know. Not only did he fail, either he ignored what he was told or he deliberately didn't tell the truth. And given his history and given his practices, we obviously feel it was the latter. He has incredible bias. He has been caught lying several times, both in his deposition and several other instances.

Finally, your Honor, we know that Dr. Edman will testify. And Dr. Edman, even as a testifying expert, has a massive problem. Dr. Edman has opined about settlement and processing in a payment system. He has no expertise and experience in it. He has never looked at the system. He has never looked at any data from the system. He has admitted that he has no idea how the one process he looked at in that system runs, and he admitted that it could very well be directed by a human being, just like a customer.

THE COURT: All right. Thank you very much.

Let me hear finally from the SEC in rebuttal.

MR. HENKIN: Your Honor, may I make a request just briefly. Not to intervene, but because there are competing summary judgment motions, may I have one minute at the end for rebuttal on ours?

THE COURT: No, you will have two minutes.

MS. STAREN: Thank you, your Honor.

So, there were a number of points that were addressed by defense counsel, and I would like to start with Chai just because it was the most recent topic of discussion. Once again, the issue is evidence. And while defense counsel can stand up here and talk at length about Project Santa, and whatever other fake transactions Do Kwon may have been talking about that were separate and apart from the fake Chai transactions that he put on the blockchain, none of that is evidence. If they have a witness -- they have 100 employees, over 42 in the United States alone. They don't have a single fact witness to come forward and say that Chai was using the blockchain, that Chai and Terraform collaborated to put these transactions on the blockchain. There is no factual evidence to support what they are saying. And again, very creative, but it's not evidence, and it cannot be used to create a genuine dispute of material fact before this Court.

I would also like to point out something interesting, two things that defense counsel said. First, he came up and he said, Terraform was using the blockchain for Chai. And I actually don't necessarily disagree with that. I think that's the whole point here. Is that Do Kwon and Terraform were telling the world that Chai was processing transactions. Chai, a real world payment processing company, was executing real world transactions between real world Chai users and real world Chai merchants. And they represented to the world that those

were happening on the blockchain. In fact, Do Kwon said, in a February 2020 discourse post, right now we have 12 merchants that are accepting payments on the Terra blockchain. And that is simply false. Because, as I mentioned before, the agreements that defendants even put into the record demonstrate, and as counsel reiterated just now, it was a 14-day settlement process. Merchants got settled in fiat currency by a transfer to their bank accounts.

So, again, the story is about Project Santa and whatever other alternative hypothetical scenarios defense counsel can come up with. It's not evidence. It doesn't create a genuine dispute. What you have here is you have the Chai CPO attesting to the fact that, in his role as chief product officer, he saw all of Chai's products lines. They all involved traditional payment processes, of bank accounts, credit cards, debit cards. It is corroborated by the undisputed record that Chai users used Chai by connecting the bank account and transferring the fiat currency to the Chai platform, and Chai transferred fiat currency to settle those transactions with merchants by transferring that currency to the merchant bank accounts. That is not in dispute.

And again, with respect to the LP server, whether or not it sits on Terraform servers or Chai servers, they were the same company for a long time. And what matters is that, as defendants have already admitted, Terraform employees were the

ones that coded, developed, controlled, operated the LP server, which they also admit is the server that was used to put those transactions on the blockchain.

And let me reinforce that it is, in fact, Terraform's own employees. Defendants admit there were two Terraform engineers that had primary roles with respect to developing the LP server. One was Paul Kim, the head engineer for Terraform. And he directly said, in an undisputed communication, that the LP server basically replicates Chai transactions. Similarly, Yun Yow, the other Terraform employee that defendants admit coded, developed, and operated the LP server, he is on record saying, we currently mirror all actual transactions between user Chai and merchant accounts. The clear implication here is that the actual transactions are not happening on the blockchain; they are happening in fiat currency off the blockchain.

Now, I would like to go back and correct something with respect to the May 2021 depeg fraud. Which is that it is not the SEC's position that we have to prove that Jump's trading was a but-for cause of the May 2021 repeg. Of course, you have our expert reports, and we obviously believe that it was, but we don't believe we have to prove that. That is not an element. All that the SEC needs to prove here is that the statements relating to that depeg were false and misleading. And the SEC's view is, because defendants brought in Jump to

intervene and buy up UST, it was false and misleading for them to represent publicly that the algorithm operated alone to restore UST's peg without the involvement of human agents.

That's it.

THE COURT: Let me hear finally from Mr. Henkin.

MS. STAREN: Thank you, your Honor.

THE COURT: Thank you.

MR. HENKIN: Thank you, your Honor.

What I want to start with is that what you have just heard from the SEC is an attempt to completely reverse the burden of proof in a case like this. The argument is essentially that, because the defendants, in the SEC's view, have not presented affirmative evidence disproving the SEC's claims, the SEC is entitled to summary judgment. Your Honor knows that's not the way summary judgment works. That's not the way the burden of proof works. And that is a fundamental issue in this case.

You just heard a flip-flop, I guess I would call it, with regard to what the SEC thinks it needs to prove with regard to Jump. That in and of itself is a demonstration that the SEC's motion for summary judgment can't be granted with respect to the May 2021 depeg, because now what you have heard the SEC say is, never mind what our expert thinks, we can prove that the statements were false and misleading independent of -- and that's exactly what was said -- independent of what caused

the May 2021 depeg.

THE COURT: Isn't the SEC right about what the law requires in that regard? Their expert may have gone further, and they may have a much broader theory, but what they have to show is that there was a material false statement or misrepresentation made with intent, and the other classic elements of fraud.

MR. HENKIN: That's right, your Honor. But that raises the question of how they are going to prove that the statements were false if the expert is not at issue. And the only thing that they have submitted with regard to that are statements by Jump employees who have admitted that they have no personal knowledge of anything that they have testified to.

One, for example, who we are going to call the Jump whistleblower, is somebody -- and I won't say the other names just so that we keep all that --

THE COURT: By the way, forgive me for interrupting. In a different connection recently, in one of my orders and one of the lesser issues raised, I reminded counsel, but I want to remind them again, to the extent this case goes to trial, nothing is going to be kept confidential.

MR. HENKIN: Your Honor, I fully remember that. If your Honor decided that today, it would be fine with me. I am not asking you to.

But the important part about that whistleblower is

that that whistleblower admitted during his deposition that he had no personal knowledge of anything he had informed the SEC about. He heard it all from other people. And he admitted it to somebody else in direct messages on Twitter that your Honor has in the record as well.

So, even if they are not relying on their experts, which is a very interesting and curious position for a plaintiff alleging fraud to take, they still don't have any admissible evidence that the statements were false or misleading.

And I want to leave your Honor with the *Howey* issue. Because what I think your Honor needs to do is look at what really was going on in *Howey*. It was stipulated in *Howey* that everyone was offered the same deal. And the same thing is true in every case that has followed *Howey*. And your Honor has the *Howey* record. It has the stipulation of facts; it has the two contracts that were offered to every single person who was given a tour of the Howey-in-the-Hills facility and a hotel; and it has a copy of the sales pitch. And the sales pitch is really interesting. Because the sales pitch includes the statement: Don't buy one of these groves unless you can take care of it and do all the things that were promised as part of the companion second written contract. And you're not going to find anything like that here. And the real issue here is, in none of those cases was it the case that a purchaser of an

asset took possession of it and decided what to do with it later. You don't have in the *Beaver* case, for example, discussions of somebody took home a live beaver and said, Oh, this isn't working out, I better go back to those people who sold me the beavers and enter into a contract. That's not the fact pattern of these cases. The fact pattern is a uniform offer of multiple contracts with bilateral obligations going forward.

And in this case, the SEC has presented no evidence of that. The best example is their reliance on the idea that LUNA purchasers could get staking rewards. But again, LUNA purchasers could only get staking rewards after they had purchased LUNA and by making a specific decision to stake, or leave, or unstake that LUNA with validators and get those rewards. Just holding LUNA didn't entitle that holder to any staking reward.

And what I would say is, even if your Honor sticks to the interpretation of *Howey* that was discussed in the motion to dismiss decision, and has been argued by the SEC, that is an individualized determination that needs to be made for each instrument based on the admissible evidence. And when you look at what the issue was in *Howey*, you will not find evidence proving each of those elements in the record.

Thank you.

THE COURT: Thank you very much. And I thank all

counsel for their excellent presentations.

I am going to go tell my new colleague that all the lawyers who appear in the Southern District are brilliant, but really it's just the three of you, and who knows about the rest.

Thank you very much.

That concludes this proceeding.

(Adjourned)